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Paul Hawken on Problem Solving
David L. Birch on Business Turbulence
Finance: Cashing In Without Cashing Out

INC.'S ANNUAL EXECUTIVE COMPENSATION SURVEY

WHAT TOP EXECUTIVES MAKE 1987

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INC. COVER STORY

INC.'S ANNUAL EXECUTIVE COMPENSATION SURVEY

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When building a business takes its toll

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Affordable alternatives to on-site day care

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THE RISE AND FALL OF EVERYBODY

Turbulence is the new fact of business life, and we'd better understand what it means

BY DAVID L. BIRCH

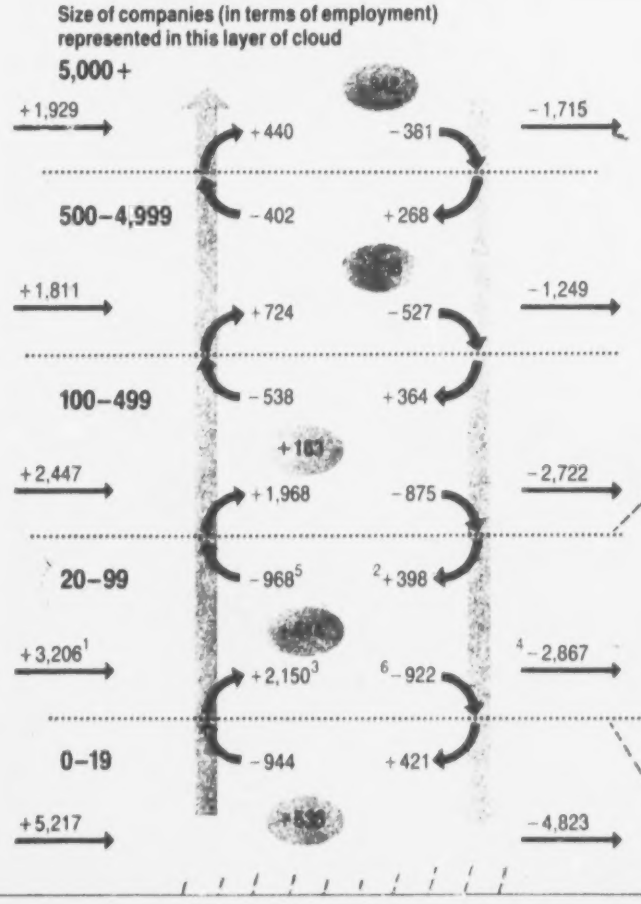
It would be easy—when admiring the sky on a summer day—to think of a far-off thundercloud as languid, majestic, even serene. But as pilots and weathermen know, it would be wrong. Inside that cloud is chaos. Huge updrafts and down drafts flow within and around it. Outwardly stable and inwardly tumultuous, it is the perfect symbol of our New Economy.

Viewed from afar, our economy too looks like a mammoth and billowy cloud, changing shape and size only slowly. Total numbers for job creation and productivity scarcely shift. Inside, though, it is a turbulent, swarming mass of companies, coming and going, rising and falling at extraordinary rates. These flows of business fortune within the U.S. economy raise a host of questions for all of us who are part of them. They constitute an almost continuous changing of the guard.

To gain an accurate picture of this activity inside the economy, we at Massachusetts Institute of Technology and now at Cognetics have been tracking the movements of about 12 million individual business establishments since 1969. We put a "tag" on each establishment (as you might tag a migrating duck) and track what happens to the establishment every six months as it moves about in the "cloud."

There is no simple way we can diagram the entire employment picture, but our economic thundercloud (see figure 1) shows some aspects of it in aggregate terms for 1982 through 1986. The arrows show how jobs move—as establishments open, close, prosper, or decline—into and out of the cloud and among its layers.

FIGURE 1 **THE ECONOMIC THUNDERCLOUD**
Job activity by company size sector, 1982–86
(All numbers in thousands if jobs, except company sizes, which are actual)



DAVID HANNUM

However sluggish the U.S. economy looks from the outside, on the inside it is anything but. Figure 1 suggests how jobs appear, vanish, or migrate among layers of the economy as businesses experience their fates. Turbulence is everywhere, despite relatively stagnant employment figures overall.

Figure 2 is a close-up of job activity among firms with 20 to 99 employees—one layer of the cloud. Its numbers are cross-referenced to the thundercloud and provide a key for interpreting other layers. Though the layers are organized by company size (and jobs move among layers as companies move) the creation and elimination of individual jobs has been tracked for each establishment. An establishment is any place people work—be it a dentist's office, a store, or a branch plant of a larger corporation. The size of a company is considered to be the cumulative size of all its establishments.

FIGURE 2

JOB ACTIVITY IN ONE LAYER OF U.S. ECONOMY
The pool of 20 to 99-employee companies (1982–86)

	(in thousands)
Total jobs in layer in 1982	13,154
[1] Jobs entering due to start-up	3,206
[2] Jobs entering due to establishments shrinking	398
[3] Jobs entering due to establishments expanding	2,150
[4] Jobs leaving due to closings	(2,867)
[5] Jobs leaving due to establishments expanding	(968)
[6] Jobs leaving due to establishments shrinking	(922)
[7] Net jobs gained by establishments remaining in layer	518
Total jobs new to layer over period	6,272
Total jobs in layer in 1986	14,669
Percent of total jobs new to layer	43%

EXECUTIVE COMPENSATION '87

THE BRAVE NEW WORLD

The 1986 Tax Reform Act has raised new questions about virtually every compensation tool a company has

BY BRUCE G. POSNER

TIME WAS WHEN EXECUTIVE COMPENSATION WAS A walk in the park. You paid your key people a competitive salary, threw in a merit raise once a year, and went about your business. Everybody was happy.

My, how times change. In recent years, executive compensation has more nearly resembled Mr. Toad's wild ride: just when you think you know where you're headed, something comes along and sideswipes you, spinning you around and sending you off in another direction. First it was persistently high inflation, which made 10% cost-of-living raises an accepted annual ritual. Then inflation abated, competition intensified, and the hot issue became "pay for performance"—that is, compensation tied to the achievement of clear goals. Scarcely had that concept taken hold than we found ourselves in the Age of the Entrepreneur, with hundreds of new companies being started every day, and the challenge of retaining key people became tougher than ever.

But all that, it turns out, was a mere taste of things to come, most of which came in 1987. It is no exaggeration to say that this year has brought more change to the world of executive compensation than any since the dawn of modern management. Granted, companies are still searching for ways to be more competitive, still looking for formulas to motivate and keep their best and brightest people. But whether you are aware of it or not, the context in which you sort through your options has been utterly transformed. No matter what business you're in, the 1986 Tax Reform Act has—to one degree or another—raised new questions about virtually every compensation tool you have.

This is not to suggest that companies are rushing to revamp their pay systems for top managers. Judging from the results of INC.'s ninth annual survey of executive compensation, most business owners are taking a wait-and-see attitude. Just 18% of the survey respondents have adjusted any of their executive compensation practices during the past year, and only 37% say they are actively considering making such changes in the coming year.

Nor do the majority appear to worry much in general about the effect of the tax laws on compensation. As in years past, respondents say that they have the most difficulty in determining the worth of a job and setting pay levels (58%), developing annual incentives and bonuses (51%), and coming up with appropriate long-term incentives or equity-participation plans (43%). Developing tax-effective compensation plans was listed as a concern by only 37% of the respondents—a higher percentage than in previous surveys, but still a distinct minority.

There is, indeed, a good argument to be made against tailoring reward systems to fit the tax laws. Moreover, companies *should* be cautious in restructuring something as important as compensation. But caution is not the same as ignorance, and no company owner can afford to remain in the dark about the implications of tax reform. They are simply too far-reaching. They affect everything you do in the area of compensation.

Take, for example, the most basic ingredient of compensation: cash. Under the old tax code, it wasn't that difficult to convince a highly paid, middle-aged executive to defer some of his annual compensation into his retirement years. By then, after all, his income would probably be lower, and so would the tax liability on the money in question. As it was, he was getting only half of each incremental dollar paid out currently (assuming he was in the 50% tax bracket). So he had a strong economic motive for setting aside a chunk of his salary or bonus and investing it on a tax-deferred basis. As for his employer, deferring compensation meant improving cash flow.

Under the new tax law, however, deferred compensation has lost its luster. It's a matter of simple math. As corporate tax rates fall from 46% to 40% to 34%, companies are faced with increasing aftertax costs of compensation and benefits in general. Meanwhile, executives find that the value of that extra dollar of current income is rising. At today's top individual tax rate, it's worth 62.5¢, rather than the 50¢ of a year ago, and it will be worth 9.5¢ more in 1988, when the rate drops to 28%. Small wonder that top executives are beginning to clamor for cash on the barrelhead. And if Congress is as likely to raise individual tax rates as many believe, there is all the more reason for executives to worry about the future

value of a deferred bonus, and to push for getting their money now.

So cash has a lot more appeal now than it did a year ago. What about equity? There, too, tax reform has had a major impact. Only yesterday, it seems, executives and ambitious employees all over the country were demanding stock in their companies, and—to some extent—the rationale was economic. Equity, after all, offered the opportunity to build personal wealth through the increasing value of the shares, and the appreciation would be taxed at no more than 20%, the maximum tax rate on long-term capital gains. For an executive in the 50% bracket, the prospect of big gains and low taxes was hard to resist.

Tax reform has certainly not eliminated the appeal of capital appreciation. (Has there ever been a better way to build a nest egg than to have the value of your company's stock soar from $5 to $50?) But, starting next year, the appreciation will be taxed at the same rate as ordinary income. That change removes a significant part of the economic incentive for owning real shares of stock, and correspondingly strengthens the case for nonequity alternatives—such as phantom stock and performance bonuses—which can be structured to give employees a chance to reap the upside rewards of growth without actually becoming owners. From the company's perspective, moreover, such alternatives are often easier to administer than real equity, in that they are not subject to securities regulations. Granted, employees may still want ownership. "But there are many ways a private company can foster a feeling of ownership without giving away actual shares," notes Donald T. Sagolla, a principal in charge of management consulting with Peat Marwick Main & Co., in Hartford. Some of those other ways are more appealing than ever.

Tax reform's impact, however, goes well beyond the effects of changing tax rates. Indeed, the new law reaches into the furthest recesses of compensation, tinkering with many of the benefits that companies have used to fill out the package they offer top executives. And here there is an unmistakable trend. In various ways, the new law tends to level out tax-favored benefits. Congress is saying, in effect, that—if you want to offer a tax break on benefits—you have to provide all your employees with more or less similar rewards. You can no longer use the tax code to compensate your top people at a level that is far beyond what you are providing the rank and file.

Perhaps the most striking example of the trend involves the rules governing 401(k) retirement plans. Under the old tax code, a well-compensated executive was allowed to place up to $30,000 a year of pretax dollars into a 401(k) account. True, the maximum allowable contribution was sometimes less, depending on the level at which other employees participated in the plan. But, even so, the 401(k) offered key executives an attractive way to save for retirement.

The 1986 Tax Reform Act has all but eliminated the 401(k) as a tool of executive compensation. Not that it abolished the 401(k), but it did introduce a whole new set of guidelines for determining how much an individual can contribute. Now, instead of $30,000 a year, the maximum annual contribution per person is just $7,000. And that's only if other employees participate at a sufficient level. Otherwise, the maximum is less. Either way, the new law substantially limits the ability of companies to use the 401(k) as a means of rewarding top executives.

And the list doesn't end there. Tax reform will affect most other areas of compensation as well—incentive stock options, bonus arrangements, nonqualified plans, you name it. What it all means is that the rules of the game have changed, and the way you play it may have to change accordingly. The question is: what should you do?

To listen to a lot of the experts, you should immediately set about restructuring your entire compensation system. Tax reform has meant a field day for consultants, who have spent the past few months scurrying around, designing orchestras of bells and whistles to play in harmony with the new tax code. They have looked at every angle, tested every scenario, run reams of spreadsheets, analyzed the financial implications of everything from cash bonuses to phantom equity to nonqualified deferred bonuses. The result, unfortunately, is utter cacophony.

Consider, for example, the issue of deferred compensation. There is no denying that current cash is worth more now than it was last year, or that it will be worth still more in 1988. Nor is there much doubt that, given present interest rates, many executives would sooner take a $10,000 bonus today than $10,000 plus interest two or three years down the line.

But does that mean you should forget about deferring compensation, as some experts contend? Well, not necessarily. Yes, there could be circumstances under which you might decide to boost morale by paying out cash bonuses, even if they do cost more than they used to. Then again, cash does have certain limitations. Even

EQUITY: THE ANCILLARY STOCK ALTERNATIVE

How Northwood Carwash Systems is solving the capital accumulation challenge

Gary D. Nowicki: **Setting up profitable ventures**

DENNIS COX

The new tax law poses real problems for a company owner who wants to offer his key people an opportunity to accumulate capital, but who is reluctant, on the one hand, to give up equity in the business or, on the other, to commit to expenses beyond what the company can afford. A number of owners have been experimenting with an approach that may offer a way out of the dilemma. It involves giving executives stock or stock options in ancillary ventures, without making them shareholders in the principal business.

A case in point is Northwood Carwash Systems Inc., a more than $2-million distributor of car-wash equipment, located in Mount Pleasant, Mich. Until last year, the 11-year-old company had a relatively conventional compensation program. The vice-president, for example, was paid a competitive salary, plus a substantial bonus based on his performance; a sales representative received a base salary of $15,000, plus commissions, plus a bonus. Then, last year, founder Gary D. Nowicki, 40, began looking for ways to tie his key people more closely to the business.

A defined benefit pension plan was too extravagant, he felt. "If profits were down, how were we going to pay for it?" And Nowicki had reservations about sharing equity, most of which had to do with control. Then it dawned on him: what if he let employees become part owners in car washes he would build? Instead of receiving their bonuses in take-home cash, they could put the money into income-producing ventures.

The first such deal came together last September, when a key employee used his $15,000 bonus to buy a one-third interest in a new car wash in Rogers City, Mich. Nowicki and a sales rep (now an employee of Northwood) put up the other two-thirds. An additional $140,000 was borrowed from a bank to pay for the equipment; they lease the land and building with an option to buy. Nowicki expects the car wash, organized as an S corporation, to begin generating income by the end of the year. "And in 15 years, the three of us will own the land and the building," he says. Meanwhile, Nowicki is thinking about offering equity in a second car wash to five or six employees, including the two who participated in the first deal.

CASH: THE EMPLOYER'S BURDEN

H.T. Lyons Inc. weighs the demand for cash against its responsibility as an employer

STEVEN M. FALK

Ted Lyons:
Offering shelter or cash

With the reduction in individual tax rates, many business owners are feeling pressure to simplify their compensation systems by scaling back deferred savings programs in favor of current cash. For conscientious employers, however, the decision is not easy, raising—as it does—questions about long-term responsibilities to employees.

Consider the case of Ted Lyons, president of H. T. Lyons Inc., a $10-million to $12-million mechanical-contracting company in Bethlehem, Pa. For the past five years, the company has provided its 20-odd office and management people with a compensation package placing strong emphasis on retirement saving. (The company has a separate pay and pension plan for about 100 unionized employees.) The package includes a profit-sharing plan, into which the company generally puts about 5% of an employee's base salary each year, and a 401(k), where it matches half of an employee's personal contribution up to 2% of base salary. Participation in the latter is close to 100%. "I really talk it up," says Lyons.

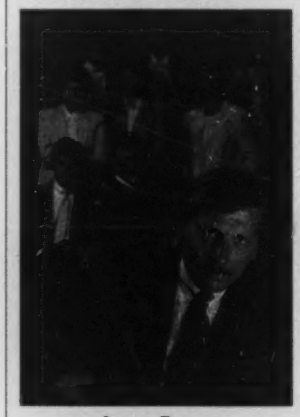
Tax reform, however, has raised questions about the system—particularly the profit-sharing part of it, since employees can't tap their tax-deferred money, without penalty, until retirement. Now that individual tax rates are falling, some of the company's top people, who earn between $40,000 and $60,000 per year including bonus, have told Lyons they would rather have profit sharing in the form of current cash.

That has put Lyons on the horns of a dilemma. On the one hand, he would like to give employees what they want. But he was troubled by the prospect of long-time employees getting ready to retire and finding that they have no savings. "That would be a real problem," he says.

Nevertheless, he finally agreed to give employees a choice in the way they receive their bonuses—but only after he was satisfied that people were adequately covered for the future by their profit sharing. "They can shelter the money," says Lyons, "or take the money and run. Either way, they'll have some money put aside that they won't be able to touch."

THE 401(K): NOW YOU SEE IT, NOW YOU DON'T

Will Wargo & Co. look for another investment vehicle for executives?



JOHN NIENHUIS

James Peters:
Attracting motivated people

The 401(k) used to be a tool for executives interested in saving for their retirement, allowing them to salt away as much as $30,000 a year, tax deferred. That's partly why Wargo & Co. set one up in 1983. Designed as a profit-sharing program for all employees, the 401(k) also served as a mechanism by which they could make additional pretax contributions on their own. "We viewed it as an excellent way to satisfy the needs of both the owners and the employees," explains James Peters, 37, cofounder and president of the $2-million human-resources consulting firm, which is located in Waukesha, Wis.

And it worked. In the first four years of the plan, most of Wargo's 30 employees contributed their own money to the 401(k) plan. The company matched annual employee contributions by an amount as high as 10% of a person's base salary, and allowed participants to borrow against their accounts. The executives, in particular, took advantage of the plan, four of them each investing well over $7,000 a year. And two of the top people, notes Peters, have been putting in around $18,000.

Now the rules have been changed, placing a cap of $7,000 on annual personal contributions and reducing the appeal of the 401(k) as an investment vehicle for better-paid employees. "There's no question that capital accumulation will be a lot tougher," says Peters. While he does not intend to terminate the 401(k), he has recently started working with attorneys and consultants to develop an additional plan, which he considers essential for attracting and retaining talented people.

Peters says it's too early to say for sure what the new program will encompass, although one of the options under consideration is equity participation. In any event, the plan will probably be open to the entire staff. "Our success," he says, "is a function of the quality of our people. They're smart, they're motivated, they're entrepreneurial, and they want to participate in the growth of the business. If we don't recognize that, we'll lose them."

your executives would probably concede that, unlike money invested in a company plan, paid-out cash often has a way of disappearing. More important, it won't do much to keep managers focused on longer-term goals. If you reward people strictly for short-term results, don't be surprised when you get short-term thinking. If that's not what you want, you might do better giving bonuses with, say, three- to five-year payouts, no matter what the experts say.

Similarly, beware of advice that suggests stock and stock options are now obsolete. Tax reform may have reduced the economic appeal of real equity, but employees seldom push for equity participation on economic grounds alone. Phantom stock is not the same as shared ownership, even if it is designed to provide identical financial rewards. Nor is it likely to produce the same level of commitment to the business that an honest-to-goodness shareholder feels.

What's more, it's doubtful that the nonequity alternatives will long remain on an economic par with real equity. "I don't know anybody who expects the tax rates we have today to stay in place for very long," says Heidi Toppel, a principal with The Wyatt Co., a compensation- and benefits-consulting firm with offices in New York City. The betting is that, within a couple of years, Congress will raise personal tax rates, restoring the preference for capital gains. If that happens, bona fide equity will once again enjoy a financial advantage over its ersatz look-alikes, and the clamor for real stock will generate as many decibels as before. *(continued)*

EXECUTIVE COMPENSATION '87: SURVEY RESULTS

THE CEO...
A profile of the typical chief executive officer

Total compensation	$96,811
Base salary	$74,379
% receiving bonus	48%
Bonus as a % of base salary (median)	25%
% change in total compensation (1985–86)	23%
Age	46
Years with the company	12
% who are founders	68%

EXECUTIVE COMPENSATION BY COMPANY SIZE
How much the top four officers received in salary and bonus, by annual company revenues

	CEO	COO	CFO	CMO
$10 million or more	$177,858	$106,320	$72,048	$88,588
$5 million to $9.99 million	$118,529	$72,283	$61,089	$64,673
$1 million to $4.99 million	$93,208	$62,836	$53,140	$61,595
Less than $1 million	$54,710	$46,039	$37,066	$42,171

THE EXECUTIVE BONUS
How companies provided bonuses to their top officers

Companies paying bonuses	83%
*Basis for allocation of bonuses**	
Discretionary	58%
Achievement of sales goals	24%
Achievement of profit goals	30%
% of sales	8%
% of profits	28%
Return on equity, assets, & sales	8%
Companies with a bonus pool	72%
*Basis for establishing bonus pool**	
Discretionary	65%
By a fixed formula	20%
By a formula set annually	19%

*Totals exceed 100% because of multiple responses.

EXECUTIVE BENEFITS AND PERKS
The benefits and perks that companies provided to their top officers

	CEO	COO	CFO	CMO
Company car & expenses	82%	66%	57%	71%
Supplemental life insurance*	64%	60%	59%	58%
Supplemental medical insurance*	41%	39%	41%	39%
Tax-return preparation	52%	32%	26%	23%
Club dues & expenses	44%	28%	25%	26%
Personal tax & financial planning	31%	17%	14%	12%
Annual physical examination	28%	28%	27%	28%
Low- or no-interest loans	26%	18%	21%	18%
Supplemental retirement benefits*	15%	13%	14%	13%
Deferred compensation	16%	15%	15%	13%
First-class air travel	11%	8%	7%	7%

*Beyond customary companywide benefits

...AND HIS COMPANY
A profile of the typical company

Total revenues	$6,102,000
Employees	105
1986 payroll	$1,345,000
Payroll as a % of revenues (median)	26%
% that are privately owned	95%

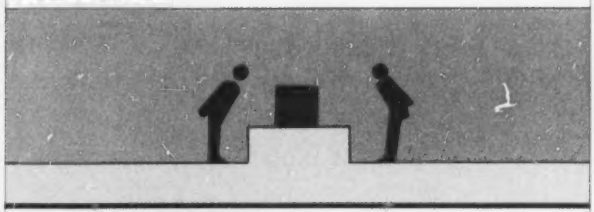
Of course, equity may not seem like a pressing matter at your company. It seldom does—until a key employee threatens to leave, or actually leaves. Yet the issue of executive benefits is hard for any company to ignore, if only because of competitive pressures. Here, too, you have to weigh carefully your options under tax reform. Unfortunately, you may not have many, at least when it comes to retirement planning.

At first glance, you might be tempted to offset the new limitations on tax-favored programs by increasing your executives' current compensation. Then they can take responsibility for their own retirement and invest the money as they please. This approach, though, has a major drawback: it gives key executives little incentive to stick around your company beyond the end of the year. An alternative is to offer them nonqualified deferred compensation—money that would only become available on retirement (or whenever you designate). Such a plan may not help your cash flow: unlike funds set aside under a tax-qualified plan, a company can deduct nonqualified retirement benefits only when the individual involved actually receives them. But at least it would give executives a reason to stay with you for the long haul.

That probably sounds good enough, and anyway you don't have many choices. There's a catch, however. Your executives probably won't take you up on a nonqualified retirement plan unless they have absolute confidence in the long-term viability of your company. That's because they'll be pinning their future, and their

(text continued on page 76; additional survey results on page 74)

SERVICE



THE TYPICAL COMPANY
A profile of the typical service business

Total revenues	$3,497,000
Employees	94
1986 payroll	$979,000
Payroll as a percentage of revenues (median)	39%
Percentage that are privately owned	97%

EXECUTIVE COMPENSATION BY COMPANY SIZE
How much service company officers received in salary and bonus, by annual company revenues

Annual revenues	CEO	COO	CFO	CMO
$10 million or more	$190,506	$114,385	$78,279	$77,436
$5 million–$9.99 million	131,745	82,241	77,511	64,696
$1 million–$4.99 million	110,736	81,046	60,051	79,181
Less than $1 million	55,180	44,328	33,049	45,413

EXECUTIVE BENEFITS AND PERKS
The benefits and perks that service companies provided to their top officers

	CEO	COO	CFO	CMO
Company car & expenses	79%	58%	56%	68%
Supplemental life insurance*	62	57	63	56
Supplemental medical insurance*	42	37	43	40
Tax-return preparation	53	38	31	24
Club dues & expenses	48	33	33	29
Personal tax & financial planning	30	17	12	11
Annual physical examination	29	28	28	32
Low- or no-interest loans	25	20	22	17
Supplemental retirement benefits*	15	10	16	17
Deferred compensation	17	17	19	11
First-class air travel	10	9	6	4

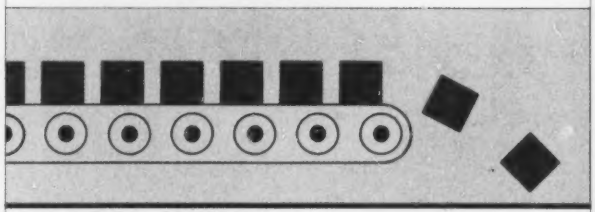
*Beyond customary companywide benefits

THE EXECUTIVE BONUS
How service companies provided bonuses to their top officers

Companies paying bonuses	82%
Basis for allocation of bonuses*	
Discretionary	59
Achievement of sales goals	26
Achievement of profit goals	31
Percentage of sales	9
Percentage of profits	24
Return on equity, assets, & sales	6
Companies with a bonus pool	73
Basis for establishing bonus pool*	
Discretionary	69
By a fixed formula	15
By a formula set annually	17

*Totals exceed 100% because of multiple responses.

MANUFACTURING



THE TYPICAL COMPANY
A profile of the typical manufacturing business

Total revenues	$8,440,000
Employees	109
1986 payroll	$1,696,000
Payroll as a percentage of revenues (median)	25%
Percentage that are privately owned	91%

EXECUTIVE COMPENSATION BY COMPANY SIZE
How much manufacturing company officers received in salary and bonus, by annual company revenues

Annual revenues	CEO	COO	CFO	CMO
$10 million or more	$170,637	$96,773	$72,743	$90,854
$5 million–$9.99 million	115,822	65,539	60,300	64,807
$1 million–$4.99 million	95,267	59,389	49,313	52,816
Less than $1 million	49,828	42,440	50,701	44,688

EXECUTIVE BENEFITS AND PERKS
The benefits and perks that manufacturing companies provided to their top officers

	CEO	COO	CFO	CMO
Company car & expenses	84%	67%	54%	72%
Supplemental life insurance*	67	63	63	60
Supplemental medical insurance*	38	41	43	38
Tax-return preparation	52	32	24	19
Club dues & expenses	39	22	17	21
Personal tax & financial planning	31	17	14	10
Annual physical examination	31	29	32	29
Low- or no-interest loans	24	14	18	13
Supplemental retirement benefits*	11	11	8	9
Deferred compensation	15	13	13	14
First-class air travel	13	8	8	9

*Beyond customary companywide benefits

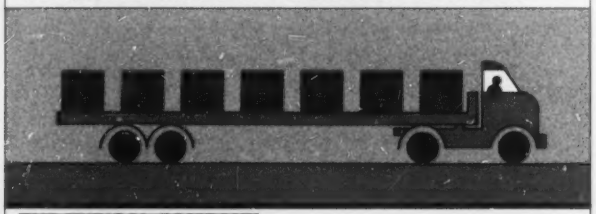
THE EXECUTIVE BONUS
How manufacturing companies provided bonuses to their top officers

Companies paying bonuses	91%
Basis for allocation of bonuses*	
Discretionary	55
Achievement of sales goals	30
Achievement of profit goals	35
Percentage of sales	6
Percentage of profits	33
Return on equity, assets, & sales	13
Companies with a bonus pool	82
Basis for establishing bonus pool*	
Discretionary	54
By a fixed formula	23
By a formula set annually	27

*Totals exceed 100% because of multiple responses.

ILLUSTRATIONS, NIGEL HOLMES

WHOLESALE/DISTRIBUTION



THE TYPICAL COMPANY
A profile of the typical wholesale/distribution business

Total revenues	$9,172,000
Employees	46
1986 payroll	$1,486,000
Payroll as a percentage of revenues (median)	16%
Percentage that are privately owned	97%

EXECUTIVE COMPENSATION BY COMPANY SIZE
How much wholesaler/distributor officers received in salary and bonus, by annual company revenues

Annual revenues	CEO	COO	CFO	CMO
$10 million or more	$161,625	$93,771	$85,286	$79,552
$5 million–$9.99 million	85,340	51,715	44,504	54,487
$1 million–$4.99 million	85,340	51,715	44,504	54,487
Less than $1 million	71,250	50,250	†	†

EXECUTIVE BENEFITS AND PERKS
The benefits and perks that wholesalers/distributors provided to their top officers

	CEO	COO	CFO	CMO
Company car & expenses	85%	69%	60%	84%
Supplemental life insurance*	71	60	51	61
Supplemental medical insurance*	37	35	32	35
Tax-return preparation	46	36	29	32
Club dues & expenses	46	31	25	24
Personal tax & financial planning	31	18	14	19
Annual physical examination	32	31	29	27
Low- or no-interest loans	26	14	11	14
Supplemental retirement benefits*	20	19	19	16
Deferred compensation	11	5	11	11
First-class air travel	10	7	6	5

*Beyond customary companywide benefits

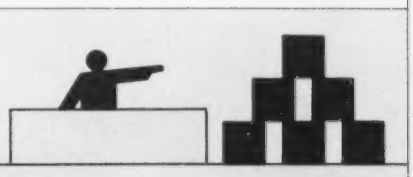
THE EXECUTIVE BONUS
How wholesalers/distributors provided bonuses to their top officers

Companies paying bonuses	85%
Basis for allocation of bonuses*	
Discretionary	60
Achievement of sales goals	20
Achievement of profit goals	29
Percentage of sales	9
Percentage of profits	34
Return on equity, assets, & sales	7
Companies with a bonus pool	77
Basis for establishing bonus pool*	
Discretionary	65
By a fixed formula	25
By a formula set annually	14

*Totals exceed 100% because of multiple responses.

†Insufficient responses for purpose of comparison

RETAIL



THE TYPICAL COMPANY
A profile of the typical retail business

Total revenues	$4,886,000
Employees	50
1986 payroll	$909,000
Payroll as a percentage of revenues (median)	16%
Percentage that are privately owned	97%

EXECUTIVE COMPENSATION BY COMPANY SIZE
How much retail company officers received in salary and bonus, by annual company revenues

Annual revenues	CEO	COO	CFO	CMO
$10 million or more	$201,730	$121,175	†	$68,495
$5 million–$9.99 million	89,367	†	†	†
$1 million–$4.99 million	56,144	40,693	†	39,667
Less than $1 million	48,330	†	†	†

EXECUTIVE BENEFITS AND PERKS
The benefits and perks that retail companies provided to their top officers

	CEO	COO	CFO	CMO
Company car & expenses	83%	78%	62%	68%
Supplemental life insurance*	62	51	55	59
Supplemental medical insurance*	46	43	45	38
Tax-return preparation	54	35	45	41
Club dues & expenses	45	24	24	32
Personal tax & financial planning	30	14	14	18
Annual physical examination	22	35	17	35
Low- or no-interest loans	24	11	17	24
Supplemental retirement benefits*	14	**	10	6
Deferred compensation	13	5	10	**
First-class air travel	11	8	**	**

*Beyond customary companywide benefits; ** means no response

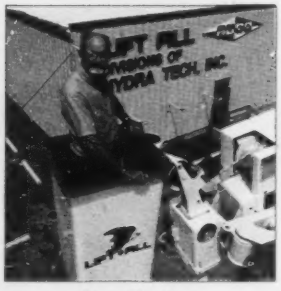
THE EXECUTIVE BONUS
How retail companies provided bonuses to their top officers

Companies paying bonuses	77%
Basis for allocation of bonuses*	
Discretionary	56
Achievement of sales goals	17
Achievement of profit goals	25
Percentage of sales	9
Percentage of profits	27
Return on equity, assets, & sales	7
Companies with a bonus pool	56
Basis for establishing bonus pool*	
Discretionary	67
By a fixed formula	22
By a formula set annually	18

*Totals exceed 100% because of multiple responses.

PROFIT SHARING: THE ONE PERCENT SOLUTION

For Hydra-Tech Inc., the "brave new world" is even better than the old one



JOHN BROOKS

Jerry Hudson:
Letting people see the profit

Tax reform has forced many companies to cast about for new ways to reward their key executives. For a few lucky ones, however, the old ways work better than ever. Take Hydra-Tech Inc., a rapidly growing manufacturer of "aerial devices," which are better known as cherry pickers. Six years ago, the Fort Wayne, Ind., company began giving its top people a share of the quarterly profits. Now, thanks to tax reform, the managers can keep more of the cash than they used to.

Founder Jerry Hudson came up with his unusual system back in 1981, when Hydra-Tech first began to turn a profit. At the time, he was already giving out quality and production bonuses, designed to keep employees focused on matters he considered critical to the company's growth. The appearance of black ink offered him an opportunity to do more. "The important thing," says Hudson, a 48-year-old former accountant, "was not to be greedy. I wanted the managers who were working hard to actually *see* the profit."

He had three key employees, all in their twenties and early thirties. Cash, he figured, would mean more to them than, say, a pension plan. Accordingly, he decided to give each of them a 1% share of the pretax profits on a quarterly basis.

Today Hudson presides over a $7-million company with 71 employees, and the profit-sharing program is going strong. The only difference is that there are now 12 key people in the system, meaning that Hydra-Tech distributes 12% of its pretax profits to executives, plant supervisors, and engineers. Recently, the quarterly checks have run in the $1,000 to $2,000 range, and they will get larger as profits grow.

As for the future, Hudson is thinking about offering his top people a chance to own stock in a new company he intends to start. That, he notes, would allow them to accumulate capital as they get older. For now, however, he wants them to focus on building Hydra-Tech and believes that his profit-sharing program encourages them to do just that.

"Some people think this is no way to run a company," he says. "But the the way I look at it, I can't lose. The more money they make, the more I make."

families' future, on the fate of the business. You can protect their retirement benefits in the event the company is sold—say, by investing the money in a special trust. But there's probably no way to cover them if the business goes down the tubes. "In the end," says Steven E. Gross, a vice-president of Hay Management Consultants, in Philadelphia, "a company's promise to pay is only as good as its financial worthiness at the time that the money is due."

So how can you engender the kind of confidence that will lead to commitment? Well, you'll have to prove your competence and judgment as a leader. You'll have to convince your key people that the way you run the business makes sense; you'll have to give them a clear idea of where the company is heading; you'll have to demonstrate your own commitment to treating them fairly. You may also find that you can generate real confidence only by giving your executives greater control over the company's destiny—which brings us right back to the question of equity. Says John F. Tallitsch, a partner with Cammock, Cammock & Tallitsch Inc., a Cleveland consulting firm specializing in benefits and compensation, "Tax reform will put more pressure on owners to give up a piece of the business." If they don't, the better executives will go to work for owners who do.

If all of this sounds a little overwhelming, there's a reason. The Tax Reform Act raises questions about executive compensation that speak to management issues lying at the heart of every business. How you meet the challenge may well play a crucial role in determining your company's success in years to come.

This is not an argument for haste, however, but for careful, thoughtful planning. Don't worry if the choices seem confusing. Executive compensation *is* confusing—all the more so given the changes in the tax laws. Today's waters are, to a large extent, uncharted; the best solutions are still waiting to be found. In searching for those solutions, the important thing is to keep squarely focused on the specific needs of your business and the people you want to motivate and retain. Yes, the rules have changed, but that doesn't mean you should redesign your whole company to fit them. In other words, don't allow the tail to wag the dog. Remember that compensation is, first and foremost, a management tool.

And one other point: don't expect the compensation system you settle on to carry you indefinitely into the future. The past 10 years of tumult have not been an aberration: they reflect important economic trends and, as such, are probably typical of what lies ahead. The simple fact is that the world of executive compensation is likely to go right on changing, and companies will feel pressure to change along with it. "What looks like a good compensation system today may have to be totally redone a couple of years from now," notes Ed Johnson, chief executive officer of The Johnson Cos., a benefits- and compensation-consulting firm located in Newtown, Pa.

So there may be a silver lining to the clouds of confusion surrounding the implications of the Tax Reform Act. It may just force company owners to do what they should be doing anyhow: to step back and reexamine their compensation systems, and to make sure they serve both the business and the people who work for it. How you pay people, after all, is not just any management tool. It's one of the most powerful tools you have. □

THE FACTS BEHIND THE FIGURES

This is the ninth consecutive year that INC. has conducted an executive compensation survey. In March, we mailed a four-page questionnaire to a random sample of 20,000 subscribers. Data Tabulation Services Inc., of Stoneham, Mass., compiled the 1,582 usable returns. To expand on the issues covered in the survey, INC. hosted a roundtable discussion in June. Among those attending the session were five of the chief executive officers who responded to the survey, as well as John F. Tallitsch, a partner with Cammock, Cammock & Tallitsch, a Cleveland consulting firm specializing in benefits and compensation.

We have prepared a special report containing the complete results of the survey. The report—while preserving the confidentiality of the survey responses—provides more detailed information than we have space to publish in the magazine. To obtain a copy, please send a written request and a check for $77 ($75, plus $2 shipping and handling) to INC. Executive Compensation Study, Attn: Mary Ellen Mullaney, 38 Commercial Wharf, Boston MA 02110, or call (800) 372-0018. In Massachusetts, call (617) 227-4700.

The survey was conducted under the supervision of special projects editor Sara Baer-Sinnott, with additional research by Teri Lammers.